

February 25, 1997

Administrative Law Judge Careaga
California Public Utilities Commission
505 Van Ness Avenue
San Francisco, CA 94102

Re: PG&E Divestiture Application (A.96-11-020)

Dear Judge Careaga:

Enclosed for filing in the above-entitled matter are two copies of the **TESTIMONY OF THE CALIFORNIA ENERGY COMMISSION FOR THE FIRST INTERIM OPINION ON PACIFIC GAS AND ELECTRIC COMPANY'S DIVESTITURE APPLICATION**. The testimony is sponsored by Robert Grow, whose qualifications are attached to the testimony, and a copy has been sent to all parties of record in this proceeding.

Very truly yours,

CARYN J. HOUGH
Attorney for the California
Energy Commission

Enclosures

cc: A. 96-11-020

**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA**

In the Matter of the Application of Pacific Gas)	A.96-11-020
and Electric Company for Authorization to Sell)		
Certain Generating Plants and Related Assets)	
Pursuant to Public Utilities Code Section 851)	
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**TESTIMONY OF THE CALIFORNIA ENERGY COMMISSION
FOR THE FIRST INTERIM OPINION ON PACIFIC GAS AND
ELECTRIC COMPANY'S DIVESTITURE APPLICATION**

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Date: February 25, 1997

INTRODUCTION

Pursuant to the Assigned Commissioner's Prehearing Conference Ruling of February 7, 1997 (Ruling), the California Energy Commission (CEC) submits this testimony on the Application of Pacific Gas And Electric Company (PG&E) to sell certain generating plants and related assets. The Application was filed with the Public Utilities Commission (Commission) on November 15, 1996, and the Commission has decided to process the application in phases. The February 7 Ruling asked parties to address five issues that will be decided in the First Interim Opinion:

- (a) whether the proposed sale is in the public interest;
- (b) whether the proposed sale process should be approved;
- (c) whether the proposed Operation and Maintenance (O&M) Agreement is reasonable;
- (d) whether the sales process will result in a determination of the fair market value of the plants; and
- (e) whether the proposed accounting and ratemaking treatment should be approved.

Our testimony addresses the first, fourth, and fifth of those issues.

I. THE COMMISSION WILL NOT BE ABLE TO DETERMINE WHETHER THE PROPOSED SALE IS IN THE PUBLIC INTEREST IN THE FIRST INTERIM DECISION BECAUSE CRITICAL ISSUES THAT AFFECT THE PUBLIC INTEREST WILL NOT YET BE RESOLVED.

While we are sympathetic to the desire of PG&E and the Commission to proceed expeditiously with the application proceeding, we believe that it is premature for the Commission to anticipate issuing a First Interim Decision in which it determines that the proposed sale is in the public interest. **This decision, if justified, should necessarily be part of the Commission's Final Decision.** A finding that the proposed sale of the plants is in the public interest must necessarily follow the Commission's

examination of all the multiple issues which together define the "public interest."

In fact, the Ruling itself provides example of issues that are relevant to a Commission determination of whether PG&E's proposal is in the public interest, but which are not scheduled to be addressed until after the First Interim Decision. These issues include the reliability and market power concerns identified for adjudication prior to the Second Interim Decision, and the possibility of significant environmental effects, which will not be examined until the appropriate environmental review is completed.

Thus, PG&E's statement that "there should be no issue as to whether these plants should be sold or that it should be done promptly" (PG&E Testimony, p. 1-2) is only partially correct. Although the CEC supports moving forward with divestiture, the outcome cannot be prejudged to be in the public interest. The fact that the Commission believes that divestiture may reduce the ability of a utility to abuse market power does not mean an evaluation of the other issues potentially associated with divestiture (such as reliability, and environmental effects) will lead to a conclusion that divestiture is in the public interest.

The CEC agrees that divestiture is a useful tool for the mitigation of market power and that Commission may find that PG&E's proposal significantly dilutes PG&E's market power. However, while we support an expeditious resolution of the issues associated with divestiture, we have also stated that divestiture is not a critical path item which must be completed prior to January 1, 1998 in order for the new market to function effectively. Concerns about the need to complete the divestiture process should not be used to justify a premature decision about the sale, or one that fails to take into account all the factors which affect the public interest. As a result, the CEC recommends that the Commission not determine whether the proposed sale of the plants is in the public interest until all issues relevant to the public interest have been fully evaluated. In addition, the CEC recommends that the Commission make a separate public interest finding for each individual sale of a plant, and for all sales that are approved in the application process in their totality. The circumstances of

individual sales may be sufficiently variable that the Commission could reach different conclusions about the environmental effects, reliability impacts, and market power effects associated with the sale. This in turn requires a transaction-specific balancing of those factors that affect the public interest. Similarly, all sales taken together may affect the public interest differently than the individual sales.

II. THE COMMISSION SHOULD ENSURE THAT ANY ACCOUNTING TREATMENT ADOPTED IN THIS PROCEEDING IS CONSISTENT WITH THAT USED IN THE COMPETITION TRANSITION CHARGE AND RATESETTING PROCEEDINGS.

The Commission is currently conducting two other proceedings in which the issue of accounting treatment of various costs may arise - the Competition Transition Charge and Ratesetting proceedings. The CEC recommends that the Commission use an accounting treatment in this proceeding that is consistent with that adopted in the other two proceedings.

III. FAIR MARKET VALUE

Whether the sales process will result in a determination of the fair market value of the plants depends on how the Commission balances its interests in maximizing the value of plants with the lack of information about the value of the must-run contract. The fair market value of the plants which will be eligible for a must-run contract will depend as much upon the terms of that contract as the physical assets themselves, with a higher value contract creating a higher market value for the must-run plants. Unfortunately, the terms of the contract are not yet known, as only a draft contract is available.¹

Moreover, in considering the draft contract, we note that it differs considerably from the draft must-run contract proposed by Southern California Edison (SCE). For example,

¹ PG&E has released the draft contract, but it has not been made a part of the divestiture filing. In any event, because the terms of the contract are critically important in assessing whether the prescribed sale process will determine the fair market value of the plants, its preliminary nature make it unsuitable for use in an in-depth fair market value analysis.

PG&E's contract would cover the full fixed costs of must-run plants, while SCE's contract would cover only half. SCE's contract also limits the energy that the Independent System Operator may take under the must-run provisions, while PG&E's contract contains no such limitation. These differences strongly suggest that one type of must-run contract will lead to a different fair market value for a specific plant than the other. The question of whether both are "fair" or whether one is "more fair" than the other, (and the impact of this determination on the public interest) may be difficult to determine. The CEC therefore recommends that the Commission not determine whether the sale will result in a determination of the fair market value of the plants until the terms of the actual contracts are available.